

§ 1.1502-16 Mine exploration expenditures.

(a) *Section 617—(1) In general.* If the aggregate amount of the expenditures to which section 617(a) applies, paid or incurred with respect to mines or deposits located outside the United States (as defined in section 638 and the regulations thereunder), does not exceed:

(i) \$400,000 minus

(ii) All amounts deducted or deferred during the taxable year and all preceding taxable years under section 617 or section 615 of the Internal Revenue Code of 1954 and section 23(ff) of the Internal Revenue Code of 1939 by corporations which are members of the group during the taxable year (and individuals or corporations which have transferred any mineral property to any such member within the meaning of section 617(g)(2)(B)) for taxable years ending after December 31, 1950 and prior to the taxable year, then the deduction under section 617 with respect to such foreign expenditures and paragraph (c) of § 1.1502-12 for each member shall be no greater than an allocable portion of such amount hereinafter referred to as the “consolidated foreign exploration limitation.” Such allocable portion shall be determined under subparagraph (2) of this paragraph. If the amount of such expenditures exceeds the consolidated foreign exploration limitation, no deduction shall be allowed with respect to such excess.

(2) *Allocable portion of limitation.* A member’s allocable portion of the consolidated foreign exploration limitation for a consolidated return year shall be:

(i) The amount allocated by the common parent pursuant to an allocation plan adopted by the consolidated group, but in no event shall a member be allocated more than the amount it could have deducted had it filed a separate return. Such allocation plan must include a statement which also contains the total foreign exploration expenditures of each member which could have been deducted under section 617 if the member had filed a separate return. Such plan must be attached to a consolidated return filed on or before the due date of such return (including

extensions of time), and may not be changed after such date, or

(ii) If no plan is filed in accordance with subdivision (i) of this subparagraph, then the portion of the consolidated foreign exploration limitation allocable to each member incurring such expenditures is an amount equal to such limitation multiplied by a fraction, the numerator of which is the amount of foreign exploration expenditures which could have been deducted under section 617 by such member had it filed a separate return and the denominator of which is the aggregate of such amounts for all members of the group.

(b) *Section 615—(1) In general.* If the aggregate amount of the expenditures, to which section 615(a) applies, which are paid or incurred by the members of the group during any consolidated return year exceeds the lesser of:

(i) \$100,000, or

(ii) \$400,000 minus all such expenditures deducted (or deferred) by corporations which are members of the group during the taxable year (and individuals or corporations which have transferred any mineral property to any such member within the meaning of section 615(c)(2)(B)) for taxable years ending after December 31, 1950, and prior to the taxable year, then the deduction (or amount deferrable) under section 615 and paragraph (c) of § 1.1502-12 for each member shall be no greater than an allocable portion of such lesser amount, hereinafter referred to as the “consolidated exploration limitation.” Such allocable portion shall be determined under subparagraph (2) of this paragraph.

(2) *Allocable portion of limitation.* A member’s allocable portion of the consolidated exploration limitation for a consolidated return year shall be:

(i) The amount allocated by the common parent pursuant to an allocation plan adopted by the consolidated group, but in no event shall a member be allocated more than the amount it could have deducted (or deferred) had it filed a separate return. Such allocation plan must include a statement which also contains the total exploration expenditures of each member for the taxable year, and the expenditures of each member which could have been

deducted (or deferred) under section 615 if the member had filed a separate return. Such plan must be attached to a consolidated return filed on or before the due date of such return (including extensions of time), and may not be changed after such date, or

(ii) If no plan is filed in accordance with subdivision (i) of this subparagraph, then the portion of the consolidated exploration limitation allocable to each member incurring such expenditures is an amount equal to such limitation multiplied by a fraction, the numerator of which is the amount which could have been deducted (or deferred) under section 615 by such member had it filed a separate return and the denominator of which is the aggregate of such amounts for all members of the group.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. Corporation X and its wholly owned subsidiaries, corporations Y and Z, file a consolidated return for the calendar year 1971. None of the corporations have in-

curred exploration expenditures described in section 617 in previous years. During 1971, X incurred foreign exploration expenditures of \$30,000, Y of \$20,000, and Z of \$40,000. The amount of foreign exploration expenditures deductible under section 617 for purposes of computing separate taxable income under § 1.1502-12 will be the amount actually expended by each corporation.

Example 2. Assume the same facts as in example (1) except that prior to 1971, X, Y, and Z had deducted (or deferred) under section 615 and 617 a total of \$300,000 of exploration expenditures. During 1971, with respect to deposits located outside the United States X incurred exploration expenditures of \$25,000, Y of \$75,000, and Z of \$125,000. The consolidated exploration limitation under paragraph (a) of this section with respect to the foreign deposits (there is no limitation with respect to the domestic expenditures) is \$100,000. X may allocate the \$100,000 in any manner among the three members, except that X may not be allocated more than \$25,000 nor Y more than \$75,000, the amount actually expended by X and Y and which they could have deducted had they each filed a separate return. If the allocation is not made in accordance with paragraph (a)(2)(i) of this section, the \$100,000 limitation will be allocated under paragraph (a)(2)(ii) of this section as follows:

Corporation	Expenditure	Fraction	Limitation	Allocable portion
X	\$25,000	$\frac{25,000}{200,000}$	× \$100,000	= \$12,500
Y	\$75,000	$\frac{75,000}{200,000}$	× \$100,000	= \$37,500
Z	\$125,000	$\frac{100,000}{200,000}$	× \$100,000	= \$50,000

The denominator of \$200,000 was calculated as follows:

X=\$25,000

Y=\$75,000

Z=\$100,000 (maximum amount allowed if filed separately)

Total \$200,000.

Example 3. Assume the same facts as in example (2) and that on January 1, 1971, X acquired all of the stock of corporation T which prior to its taxable year beginning January 1, 1971, had previously deducted (or deferred) \$310,000 of exploration expenditures. Assume further that in 1971 X incurred \$25,000 of foreign exploration expenditures, Y \$50,000, T \$50,000, and Z none. A consolidated return is filed for 1971. None of the expenditures may be deducted under section 617 since the consolidated exploration limitation is zero. The limitation is zero since the aggregate amount of previously deducted (or

deferred) exploration expenditures by the members of the group exceeds \$400,000. (The total of such expenditures is \$410,000, of which \$310,000 is attributable to T and, assuming the allocation of the limitation in example (2) is made under paragraph (a)(2)(ii) of this section, \$12,500 is attributable to X, \$37,500 to Y, and \$50,000 to Z.)

Example 4. Assume the same facts as in example (3) except that on December 31, 1971, X sold all of the stock in Z to an unrelated party. The consolidated exploration limitation for 1972 will be \$40,000, computed by subtracting from \$400,000, the aggregate amount of previously deducted (or deferred) exploration expenditures incurred by the members of the group prior to 1972. (The total of such expenditures is \$360,000, of which \$12,500 is attributable to X, \$37,500 to Y and \$310,000 to T.) Amounts previously deducted (or deferred) by Z are not taken into account since

it was not a member of the group at any time during 1972. Amounts previously deducted (or deferred) by Z shall be taken into account by it for subsequent separate return years.

[T.D. 7192, 37 FR 12949, June 30, 1972]

§ 1.1502-17 Methods of accounting.

(a) *General rule.* The method of accounting to be used by each member of the group shall be determined in accordance with the provisions of section 446 as if such member filed a separate return. For treatment of depreciable property after a transfer within the group, see paragraph (g) of § 1.1502-12.

(b) *Adjustments required if method of accounting changes—(1) General rule.* If a member of a group changes its method of accounting for a consolidated return year, the terms and conditions prescribed by the Commissioner under section 446(e), including section 481(a) where applicable, shall apply to the member. If the requirements of section 481(b) are met because applicable adjustments under section 481(a) are substantial, the increase in tax for any prior year shall be computed upon the basis of a consolidated return or a separate return, whichever was filed for such prior year.

(2) *Changes in method of accounting for intercompany transactions.* If a member changes its method of accounting for intercompany transactions for a consolidated return year, the change in method generally will be effected on a cut-off basis.

(c) *Anti-avoidance rules—(1) General rule.* If one member (B) directly or indirectly acquires an activity of another member (S), or undertakes S's activity, with the principal purpose to avail the group of an accounting method that would be unavailable (or would be unavailable without securing consent from the Commissioner) if S and B were treated as divisions of a single corporation, B must use the accounting method for the acquired or undertaken activity determined under paragraph (c)(2) of this section or must secure consent from the Commissioner under applicable administrative procedures to use a different method.

(2) *Treatment as divisions of a single corporation.* B must use the method of accounting that would be required if B

acquired the activity from S in a transaction to which section 381 applied. Thus, the principles of section 381 (c)(4) and (c)(5) apply to resolve any conflicts between the accounting methods of S and B, and the acquired or undertaken activity is treated as having the accounting method used by S. Appropriate adjustments are made to treat all acquisitions or undertakings that are part of the same plan or arrangement as a single acquisition or undertaking.

(d) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. Separate return treatment generally. X and its wholly-owned subsidiary Y filed separate returns for their calendar years ending December 31, 1965. During calendar year 1965, X employed an accrual method of accounting, established a reserve for bad debts, and elected under section 171 to amortize bond premiums with respect to its fully taxable bonds. During calendar year 1965, Y employed the cash receipts and disbursements method, used the specific charge-off method with respect to its bad debts, and did not elect to amortize bond premiums under section 171 with respect to its bonds. X and Y filed a consolidated return for 1966. For 1966 X and Y must continue to compute income under their respective methods of accounting (unless a change in method under section 446 is made).

Example 2. Adopting methods. Corporation P is a member of a consolidated group. P provides consulting services to customers under various agreements. For one type of customer, P's agreements require payment only when the contract is completed (payment-on-completion contracts). P uses an overall accrual method of accounting. Accordingly, P takes its income from consulting contracts into account when earned, received, or due, whichever is earlier. With the principal purpose to avoid seeking the consent of the Commissioner to change its method of accounting for the payment-on-completion contracts to the cash method, P forms corporation S, and S begins to render services to those customers subject to the payment-on-completion contracts. P continues to render services to those customers not subject to these contracts.

(b) Under paragraph (c) of this section, S must account for the consulting income under the payment-on-completion contracts on an accrual method rather than adopting the cash method contemplated by P.

Example 3. Changing inventory sub-method. (a) Corporation P is a member of a consolidated group. P operates a manufacturing business that uses dollar-value LIFO, and